*United States Court of Appeals*

*for the Second Circuit*

# BRIEF FOR APPELLANT

76-4174

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

| | |
|---|---|
| WILLIAM B. STRONG and CONSTANCE L. STRONG, <u>et</u> <u>al</u>., Petitioners-Appellants | CIVIL APPEAL |
| v. | |
| COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee | Docket No. 76-4174 |

APPEAL FROM DECISION OF UNITED STATES TAX COURT

1

BRIEF FOR APPELLANTS



HUNTER AND HARTNETT
P. O. Box 30
5795 Widewaters Parkway
Dewitt, New York 13214

## TABLE OF CONTENTS

## TABLE OF CASES CITED

Page

## TABLE OF STATUTES CITED

## TABLE OF OTHER AUTHORITIES CITED

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

| | | |
|---|---|---|
| WILLIAM B. STRONG and CONSTANCE L. STRONG, *et al.*,[1]<br><br>Petitioners-Appellants<br>v.<br><br>COMMISSIONER OF INTERNAL REVENUE,<br><br>Respondent-Appellee | ) | CIVIL APPEAL<br><br>Docket No. 76-4174 |

## BRIEF FOR APPELLANTS

### STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

Does the fact that bare legal title to real property resides in a corporation solely to satisfy a State usury statute require that the corporation be deemed to be the owner of the property for federal income tax purposes where the facts show that the corporation only executed documents necessary for financing and that the real and beneficial owner is a partnership?

---

1 Cases of the following petitioners are consolidated herewith: Fred W. Pollman and Agnes K. Pollman, docket No. 2174-74; Paul W. Henninger and Mabel E. Henninger, docket No. 2175-74; Victor L. Alger and Coral E. Alger, docket No. 2206-74; Frederic B. Adler and Helen P. Adler, docket No. 2207-74; and Colburn A. Jones and Patricia L. Jones, docket No. 2208-74.

## STATEMENT OF THE CASE

Introduction

The appellants ("taxpayers"), partners in Heritage Village Apartments Company, deducted on their individual 1968 and 1969 federal income tax returns their respective share of tax losses resulting from the construction and ownership of an apartment project.

To obtain financing for the project, title had to be conveyed to a corporate borrower in order to avoid violating the New York usury statute (the interest rate would have been usurious but for the statutory exception which permitted such loans to a corporation). The sole purpose for using the corporation was to satisfy the usury statute and it was intended by the partners (and made known to Internal Revenue Service) that the partnership be at all times the real and beneficial owner of the project.

Internal Revenue Service disallowed the partners' deductions of the partnership tax loss, contending that the corporation was the owner of the project for tax purposes and that such tax losses were corporate losses not deductible by the partners in 1968 and 1969.

The Tax Court decided in favor of the Commissioner of Internal Revenue. William B. Strong and Constance L. Strong, et. al. v. Commissioner of Internal Revenue, 66 T.C. No. 3, CCH Dec. 33,748 (1976).

Appeal to the Second Circuit Court of Appeals was timely made by appellants.

Statement of Facts

As the taxpayers have no significant disagreement with the facts as found by, and set forth in the opinion of the Tax Court, its findings are set forth herein.

All of the petitioners are individuals who filed joint Federal income tax returns for the years 1968 and 1969 with the Internal Revenue Service Center at Andover, Massachusetts. At the time the petitions were filed, Victor L. and Coral E. Alger, Frederic B. and Helen P. Adler, William B. and Constance L. Strong, and Colburn A. Jones resided in Delmar, New York; Patricia L. Jones resided in Syracuse, New York; Paul W. and Mabel E. Henninger resided in Castleton, New York; and Fred W. and Agnes K. Pollman resided in Phoenix, Arizona. The parties have stipulated that any appeal in these cases "shall be taken in the United States Court of Appeals for the Second Circuit at New York, New York."

Prior to September, 1967, Colburn A. Jones, William B. Strong, Victor L. Alger, Frederic B. Adler, Fred W. Pollman and Paul W. Henninger agreed to form Heritage Village Apartments Company, a partnership, for the purpose of developing an apartment complex to be known as the Heritage Village Apartments. The partners understood at that time that financing in the amount necessary to develop the apartments was not available to individuals because of the limitations on interest charges in the New York usury statute. They understood that corporations were not subject to these limitations, and that financing might be available to a

corporate borrower. Accordingly, Heritage Village, Inc., a corporation owned by the partnership (hereinafter referred to as the "corporation"), was formed in September, 1967 in anticipation of its use to obtain loan commitments. Jones was named as president and Robert V. Hunter as secretary of the corporation. The certificate of incorporation contained a broad and unqualified statement of purposes and authorized the issuance of 200 shares of capital stock without par value.

In October, 1967, certificates of partnership were filed by the partners on behalf of Heritage Village Apartments Company (hereinafter the "partnership").

In August, 1967, before either the partnership or the corporation was formed, a commitment for a permanent mortgage loan was obtained from the Bronx Savings Bank (hereinafter Bronx). This loan was to bear interest at 6-3/4 percent and was to be secured by an eighteen (later nineteen) building apartment project. The commitment letter was addressed to "Heritage-State Farm Corp. c/o Mr. Colburn A. Jones".

The apartment project was to be constructed in three phases on separate parcels of land. By letter dated December 8, 1967, Chemical Bank New York Trust Company (hereinafter Chembank) made a commitment to loan the corporation $2,100,000, bearing annual interest of 7 percent, for the purpose of constructing the first phase, known as "parcel 1." Among other things, the letter required that Jones and his wife

personally guarantee the mortgage note. The partnership as "owner" had previously contracted with Heritage-State Farm Corporation (hereinafter the contractor) to construct the apartments on parcel 1.

On December 18, 1967, the partners entered into a formal partnership agreement. Among other things, [2] the agreement provided that Strong, Adler, Henninger and Alger, as partners in Strong and Company, were to transfer certain real property designated parcel 1 "to the partnership or its nominee". It also provided that:

> It is agreed that title to the aforesaid Parcel may be held by a corporate nominee for the benefit of the partnership, it being the intention of the parties hereto that at all times the real and beneficial owner of the said Parcel shall be the partnership.
>
> * * *
>
> 6. Construction on Parcel 1 -- The parties hereto agree that Jones shall have and is hereby granted the authority on behalf of the partnership (through a nominee corporation, if determined by Jones and Strong) to negotiate for and enter into a Con-

---

2 The ownership interests provided for before and after the admission of a new partner, Robert Flannigan, on August 21, 1969, were:

| Partner | Percentage of Ownership Prior to 8/21/69 | After 8/21/69 |
|---|---|---|
| Jones | 65.00 | 62.00 |
| Strong | 16.43 | 20.37 |
| Adler | 3.57 | 4.43 |
| Henninger | 3.57 | 4.43 |
| Alger | 1.43 | 1.77 |
| Pollman | 10.00 | 4.00 |
| Flannigan | --- | 3.00 |

Flannigan deducted no distributive share of partnership losses in 1969.

> struction Loan Agreement, first or subordinate mortgage financing and related instruments * * * to finance the construction of the apartment units and related improvements on Parcel No. 1.
>
> * * *
>
> Jones agrees to guarantee such construction loan in the event that the lending institution shall request.
>
> Promptly upon execution of this Agreement the partnership shall enter into a Construction Agreement with Heritage-State Farm Corp., a New York corporation, the sole shareholder of which is Jones and/or his spouse. * * *
>
> Such construction * * * shall be in accordance with plans and specifications which shall be prepared on behalf of the partnership * * *.
>
> * * *
>
> 9. Authorized Signatures on Behalf of Partnership: The joint signatures of Jones and Strong shall be required on all deeds by the partnership, on any Construction Loan Agreement and on any bond and mortgage executed by or on behalf of the partnership.

All documents hereinafter referred to as executed by the corporation were signed only by Jones, as president.

Also on December 18, 1967, the members of Strong & Company entered into a separate agreement whereby Strong, Adler, Henninger and Alger would convey real property, known as parcels 2 and 3, to the partnership. That agreement stated that it was an amendment to the partnership agreement and contained language similar to the above-quoted portions of the partnership agreement in respect of the conveyance to the partnership or its nominee and the holding of title by a corporate nominee for the benefit of the partnership. It also provided for the reconveyance of parcels 2 and 3 to the aforementioned named individuals under certain circumstances.

On August 21 and December 18, 1969, the partnership agreement was twice amended in respects not material herein. The August 21, 1969, agreement constituted a restatement thereof to admit Flannigan (see footnote 2, supra) and incorporated the previously agreed upon provisions relating to parcels 2 and 3; the corporation was not a party to this agreement.

A deed transferring parcel 1 from Strong, Adler, Henninger, and Alger to the corporation pursuant to the partnership agreement was executed on December 27, 1967, and recorded on January 8, 1968. Parcels 2 and 3 were deeded to the partnership and the deeds recorded in January, 1968.

A building loan agreement and mortgage respecting parcel 1 between the corporation as mortgagor and Chembank as mortgagee was executed on December 29, 1967, and recorded on January 8, 1968. Paragraph 4(e) of the agreement provided:

> 4. Representations and Warranties. Borrower represents and warrants to Lender that:
>
> * * *
>
> (e) If Borrower purports to be a corporation, (i) it is a corporation duly organized, existing and in good standing under the laws of the state in which it is incorporated, * * * (iii) it has the corporate power, authority and legal right to carry on the business now being conducted by it and to engage in the transactions contemplated by this Agreement, the Note and the Mortgage, and (iv) the execution and delivery of and the carrying out of the transactions contemplated by this Agreement, the execution and delivery of the Note and the Mortgage, and the performance and observance of the provisions of all the foregoing, have been duly authorized by all necessary corporate and stockholder actions of Borrower and will not conflict with or result in a breach of the terms or provisions of any existing law or any existing rule, regulation or order of any court or governmental body or of the Certificate of Incorporation or the By-Laws of Borrower.

The agreement also recited that the corporation was the owner of the mortgaged property, and provided that it could not be assigned by the borrower without the consent of the lender and that any assignment in violation of this provision was an event of default. The agreement also included the following:

> 8. (c) Borrower shall furnish to Lender from time to time upon request (i) financial statements of Borrower, (ii) details relating in any manner to the financial condition of Borrower, and (iii) budgets and revisions of budgets of Borrower showing the estimated cost of construction of the Improvement and the amount of funds required at any given time to complete and pay for such construction.

The accompanying mortgage included an assignment of rents to Chembank and various covenants and warranties concerning the property. The loan was personally guaranteed by Jones.

During the year 1968, the first eighteen apartment buildings on parcel 1 were completed. As buildings were completed, they were leased to tenants. Leases were executed in the name of the partnership as landlord. Upon completion of the buildings, Chembank assigned the mortgage indebtedness on parcel 1 to Bronx. An extension agreement between Bronx and the corporation was recorded on January 15, 1969. The extension agreement referred to a declaration of easement recorded simultaneously therewith by which the corporation as owner of parcel 1 and the partnership as owner of parcels 2 and 3 granted mutual easements. An amended declaration of easement was executed by the corporation, the partnership, Bronx, and Chembank on April 18, 1969.

In December, 1968, the corporation obtained an insurance policy on the apartments naming itself as the insured. The policy covered completed portions of the project and was extended from time to time to include new buildings. In December, 1969, the named insured was changed to read "Heritage Village Inc. and Heritage Village Apartments Company." The policy protected against destruction of the buildings and loss of rents.

By letter dated February 5, 1969, Chembank issued to the corporation a commitment to lend it $135,000 for the purpose of constructing an additional building on parcel 1. This loan was to bear interest at 8 percent. A loan agreement, mortgage, and note were executed by the corporation the following month. The loan agreement and mortgage contained substantially the same provisions regarding ownership of the property, existence and validity of the corporation, furnishing of financial statements and assignment as were contained in the original building loan agreement (see pp. 7 and 8, supra). Jones and his wife personally guaranteed both repayment of the loan and completion of the building.

The partnership decided to proceed with construction of additional apartments on parcel 2. In January, 1969, the partnership and the contractor contracted for that construction. In March, 1969, a commitment was obtained from Albany Savings Bank (hereinafter Albany) for a building loan of $2,150,000 bearing interest at 7-3/4 percent. The commitment letter was addressed to the partnership, but pro-

vided that the obligor and mortgagor would be "[a] corporation to be formed by you." In May, 1969, a resolution on behalf of the corporation was executed authorizing the building loan and authorizing Jones and Hunter to execute necessary documents on behalf of the corporation. A mortgage and note, together with Jones' personal guarantee, were executed by the corporation shortly thereafter. The mortgage was recorded simultaneously with a deed transferring parcel 2 to the corporation.

In April, 1969, the corporation gave a mortgage on parcel 3 to the Merchants National Bank and Trust Co. (hereinafter Merchants) to secure the amount of $75,000. Title insurance for this loan was obtained, with respect to which a form was issued listing "TITLE IN: Heritage Village Apartments Company" and "TITLE TO BE IN: to be advised". In June, 1969, a deed transferring parcel 3 from the partnership to the corporation was recorded.

In July, 1969, the corporation and Bronx by agreement consolidated and extended to December 27, 1983, the two construction loans on parcel 1, both of which by that time had been assigned to Bronx. The consolidated loan bore interest at a rate of 6.81 percent. An affidavit sworn to by Jones and attached to the extension instrument recited that the corporation was the owner of the subject premises.

In December, 1969 (the last year in issue), Jones wrote

a memorandum to Aaron Kaiser [3] which read in part:

> Please prepare a deed for all the lands and parcels 1, 2, and 3 of Heritage Village. You are to convey title from Heritage Village, Inc. to Heritage Village Apartments Co. as soon as the January advance is received from the Albany Savings Bank. The reason for this transfer involves IRS considerations.
>
> It will be necessary in February to transfer the property back to Heritage Village, Inc. for the purpose of receiving the February advance. As soon as the advance is made, you are to again transfer the property back to Heritage Village Apartments Co.
>
> In other words, as of approximately January 10, 1970, the only time the title will rest in the corporation will be at the moment an advance is made. We will, of course, reimburse you for any out-of-pocket legal expenses involved in the drawing of the documents. If you have any questions, kindly call me.

In January, 1970, after receipt of the January advance from Albany, all three parcels were deeded back to the partnership by the corporation. The property was transferred to the corporation in February, 1970, and then back to the partnership after receipt of the February advance. This procedure continued until May, 1970, when a warranty deed with full covenants was recorded, transferring all parcels to the partnership.

The buildings on parcel 2 were completed late in 1969 and early in 1970. The swimming pool and recreation center, located on parcel 3, were completed in late 1969. As each apartment building was completed, leases were executed between the partnership and tenants. Promotional literature

---

3 The relationship of Kaiser to any person mentioned herein is not disclosed on the record.

describing the partnership as owner of the project was distributed to prospective tenants.

During 1968 and 1969, the corporation maintained checking accounts at Chembank and Merchants. Advances on construction loans were deposited to these accounts and transferred by check either to the partnership or, if time was a factor, directly to the contractor. Receipts for all advances were signed by Jones as president of the corporation. The corporation kept no books or records other than the records of these accounts. Except for the advances on the construction loans and the disbursements thereof as aforesaid, all receipts and disbursements, income and expenses, and assets and liabilities pertaining to the construction and operation of the apartments -- including rentals and all real estate taxes and water charges -- were at all times received or made by, and carried on the books and records of, the partnership.[4]

The corporation issued no capital stock. No corporate meetings were held nor minutes maintained.[5] It filed Federal income tax returns but reported no income, loss, assets or liabilities, reporting its principal business activity as "Nominee Corp." It did not apply for a Federal employer identification number[6] and had no employees.

---

4 The commitment fee on the Albany loan was paid by the contractor, which was reimbursed by the partnership.

5 The record does not indicate how the corporate resolution referred to on page 10, <u>supra</u>, was adopted.

6 A number was assigned by the Service Center with which the corporate income tax returns were filed.

From 1968 to 1970, the partnership employed various persons. Initially, these employees were carried on the payroll of the contractor as a matter of convenience; the contractor periodically billed, and was reimbursed by, the partnership for such compensation. Beginning in 1970, the partnership operated its own payroll account. It applied for and received an employer identification number.

In October, 1967, permission was applied for in the name of the partnership to connect into the water distribution system of the Town of Guilderland to service the needs of the planned apartments.

In November, 1967, a permit was issued to the partnership to install sewer pipe to serve the apartments.

Certain utility easements encumbering the real property were released by agreement between the partnership and the utilities in August, 1968. The agreement recited that the partnership was the owner of the premises.

In October, 1969, the New York Department of Transportation issued to the partnership a permit to perform certain road work at the site of the apartment buildings.

Effective in October, 1969, a settlement of claim for penalty for violation of state conservation laws by alteration of creek banks and beds at the site was entered into on behalf of the partnership with the New York Conservation Department.

In September, 1969, the partnership applied for a permit to install a culvert pipe to permit the flow of a

creek under a road at the apartment site. The permit was granted in November 1969.

The partnership prepared financial statements beginning with the year 1968. No financial statement of the corporation was ever prepared.

No assets other than the real property of the partnership were ever formally transferred to the corporation. The corporation was dissolved in September 1973.

## SUMMARY OF THE ARGUMENT

The central issue before this Court is whether the limited use of the corporation should have the effect under the federal income tax law of transforming all of those activities admittedly performed by the partnership (incurring and paying construction costs, receiving income and paying expenses) into corporate activities.

That is, is the mere holding of fee title to satisfy state usury laws such a significant activity that the corporation is deemed to have performed all of the numerous business transactions which in fact were performed by the partnership (as the statement of facts shows)?

The partners submit that there is no policy or legal reason for ascribing the entire ownership and operation of the project during 1968 and 1969 to the corporation when, in fact, all of the business activities were done by the partnership in its own name.

In fact, if it were possible to detail every transaction during 1968 and 1969 under two categories, one being those done in the corporate name, and the other being those done in the partnership name, the only entries under the corporate category would be these:

Received title to the property;

Executed mortgage loan instruments; and

Turned over loan advances to the partnership (or directly to its contractor).

In contrast, the list of partnership activities during 1968 and 1969 would be so voluminous as to be impractical to itemize here, but their extent and scope are evident from these general categories:

Development of all plans for the project (the corporation had no employees; the partners had necessarily to perform such function as the extract of paragraph 6 of the partnership agreement quoted above indicates);

Handling all construction matters with the general contractor (the corporation had no employees so necessarily the partners had to do this);

Preparing all material for promoting the leasing of the apartments and interviewing all prospective tenants (the process of leasing apartments actually begins during the construction phase);

Hiring and supervising employees to maintain the project, such as maintenance personnel, leasing personnel, swimming pool personnel, bookkeeping and accounting personnel; and

Collecting the monthly rent from tenants, and paying the various costs of operating the project.

The above transactions were done in the partnership name, so all of the risks of personal liability to the partners were present. The corporation was not used in any sense as a shield against such liability.

The Commissioner has given no policy reasons why the mere holding of fee title in a corporation (in the face of

so many other transactions being avowedly performed in partnership name) should call for such a severe result as he proposes, i.e., disregarding the partnership.

## ARGUMENT

I. <u>THERE EXISTS SOUND PRECEDENT FOR DISREGARDING THE CORPORATE NOMINEE FOR FEDERAL INCOME TAX PURPOSES AND RECOGNIZING THE REAL AND BENEFICIAL OWNER OF PROPERTY AS THE OWNER FOR TAX PURPOSES</u>

The Tax Court recognized that the partners of Heritage Village Apartments Company were faced with a classic dilemna -either transfer title to a corporation in order to obtain the needed funds from the lending institutions or give up development of the project. The partners wanted a partnership because of the double imposition of taxes which results from corporate ownership and the pass-through of income to the individual shareholders, as well as the desire to offset losses on this project against income from other activities.

The situation was in no way unique to this project and has been faced many times in the past by New York real estate partnerships. Insofar as New York State law is concerned, using a corporate nominee is accepted practice (Tax Court Opinion at slip page 18-19). See <u>Jenkins v. Moyse</u>, 254 N.Y. 319, 172 N.E. 521 (1930); <u>Leader v. Dinkler Management Corporation</u>, 20 N.Y. 2d 393, 283 N.Y.S. 2d 281, 231 N.E. 2d 765 (1967); <u>McNellis v. Merchants National Bank and Trust Company of Syracuse</u>, 390 F. 2d 239 (2 Cir. 1968).

There exists in the Second Circuit sound precedent for disregarding the corporate nominee for federal income tax purposes and recognizing the partnership as the real owner for tax purposes. The partners and/or their counsel

were aware of these in deciding to undertake the construction and ownership of the project in the manner shown by the statement of facts (and now retroactively found by the Tax Court to produce tax results completely inconsistent with these precedents).

These cases are summarized below:

1. <u>Samuel S. Paymer v. Commissioner of Internal Revenue, 150 F. 2d 334, 45-2 USTC ¶9353 (2 Cir. 1945)</u>

The case involved two corporations, Raymep and Westrich. Individual partners who organized the corporations contended the corporations should be disregarded as mere nominees. The tax year involved is 1938.

This Court concluded Westrich is a true nominee and Raymep is not to be disregarded. Thus, the facts distinguishing the two become critical.

As to <u>Raymep</u>, the facts showed:

(a) Its certificate of incorporation granted it broad powers to own, manage and dispose of real estate;

(b) One-half the capital stock was issued to each of the two individual partners;

(c) The corporate minutes at the time the real estate was conveyed to the corporation stated the corporation was organized for the convenience of the stockholders and was to hold title for the benefit of the stockholders;

(d) After the initial organizational meeting

where the president and treasurer were elected, no other officers were elected and no other corporate meetings were held;

(e) In 1937 the corporation itself entered into a lease with a tenant extending a lease previously entered into (this appears as Finding of Fact number 8 in the opinion of the Tax Court, 1 T.C.M. 362, CCH Dec. 12,930-B (1943)); and

(f) In 1938 the corporation obtained a loan and assigned two leases as security.

Based on the foregoing facts, this Court concluded that "... Raymep was active enough to justify holding that it did engage in business in 1938" so that its rental income should be taxed to it rather than its stockholders (150 F. 2d at page 336).

As to Westrich, the facts showed:

(a) Its certificate of incorporation granted it broad powers to own, manage and dispose of real estate;

(b) One-half the capital stock was issued to each of the two individual partners;

(c) The corporate minutes at the time the real estate was conveyed to the corporation stated the corporation was organized for the convenience of the stockholders and was to hold title for the benefit of the stockholders; and

(d) After the initial organizational meeting

where the president and treasurer were elected, no other officers were elected and no other corporate meetings were held.

This Court concluded that Westrich "... served no business purpose in connection with the property and was intended to serve only as a blind to deter the creditors of one of the partners." (150 F. 2d at page 337).

To hold that the economic substance of the transaction amounts to engaging in business, a higher level of business activity than is present in the instant case is required. Paymer indicates that such higher level of business activity includes income-producing transactions (i.e., a lease executed by the corporation; in Paymer extending a lease with a tenant previously entered into). The facts summarized above show that Heritage Village, Inc. engaged in no similar income-producing transaction.

2. Thomas J. O'Neil v. Commissioner of Internal Revenue, 170 F. 2d 596, 48-2 USTC ¶9406 (2 Cir. 1948), cert. denied 336 U.S. 937, 69 S. Ct. 747

Howard A. Jackson v. Commissioner of Internal Revenue, 233 F. 2d 289, 56-1 USTC ¶9506 (2 Cir. 1956)

The corporations in the O'Neil case were organized so the individual shareholder could have title in the corporate name to enable him to deal with the property without his wife's signature.

The corporations issued no stock, kept no books or records.

In holding that the corporations were not to be recognized as a separate entity for tax purposes, this Court said:

> "The only disclosed reason for their organization and for their being kept in existence until they were dissolved was to make it unnecessary for the petitioner to procure from time to time his wife's signature to some papers ... That slight approach to a business purpose did not amount to business activity ..." (170 F. 2d at page 598)

In affirming the decision of the Tax Court, this Court in <u>Jackson</u> agreed that the corporation was a mere nominee to own a wife's stock in order to protect it from her husband's creditors.

The use of a nominee and its non-recognition as a taxable entity was expressly sanctioned by this Court. It stated (in footnote 2 to the opinion):

> "A natural person may be used to receive income which in fact is another's. So, too, a corporation, although for other purposes a jural entity distinct from its stockholders, may be used as a mere dummy to receive income which in fact is the income of the stockholders or of someone else; in such circumstances, the company will be disregarded." (233 F. 2d at page [illegible])

In effect the Tax Court in the instant case is simply ruling out the use of nominee corporations because it states (at page 25 of Opinion) that "If the corporation was intended to, or did in fact, act in its own name with respect to property, its ownership thereof will not be disregarded."

But a nominee corporation would virtually <u>always</u> "act in its own name" as that is essentially why it is used.

A nominee corporation is one necessary ingredient; yet it is purely a legalistic requirement that ought not so totally over-shadow the many other transactions performed in partnership name as to totally defeat the acknowledged intent that the real owner for all purposes (not just for tax purposes) be the partnership.

3. Commissioner of Internal Revenue v. State-Adams Corporation, 283 F. 2d 395, 60-2 USTC ¶9768 (2 Cir. 1960), cert. denied 365 U.S. 844, 81 S. Ct. 802

Property in Chicago was conveyed to the corporation so that, on the death of the elderly individual then the sole income beneficiary of the trust that had owned the property, state law would not be violated which barred aliens from owning Illinois real estate. The trust became the sole stockholder of the transferee corporation.

The property was conveyed to the corporation subject to an existing lease by a department store. A promissory note was taken back by the trust, the interest on which exactly equaled the rent which the corporation would receive under the lease.

Since 1933 when the corporation was organized some ten directors' meetings were held and minutes kept.

The corporation filed tax returns, reported the rental income with small deductions for miscellaneous expenses and one large interest expense deduction.

The Court stated that the corporate entity would be recognized because:

"This is not a case where the corporation was a mere nominee, powerless to act with respect to the land other than with consent of the beneficiary owners. ... This is not a case where income belonging to the shareholders was received in form by the corporation. The income belonged to the corporation, and was paid directly to the shareholders only because this suited the purpose for which the corporation had been established." (283 F. 2d at page 397, 398).

See also United States v. Brager Building and Land Corporation, 124 F. 2d 349, 41-2 USTC ¶9799 (4 Cir. 1941).

The facts in the instant case would require non-recognition based on the factors quoted above because:

1. This is a case where the corporation was used by the partners as a mere nominee. This fact was recognized in the opinion of the Tax Court (at page 19 of Opinion).

2. The corporation received no income. Income was not reported by the corporation nor was it attributable to the corporation.

3. The partners at all times represented that the partnership was the proper recipient of the income from the property since it was the real and beneficial owner.

## Precedents in Other Courts

There are summarized below cases in the United States Supreme Court and in other circuits and the Court of Claims which have dealt with the issue of the recognition of a cor-

poration for tax purposes. The listing of the transactions completed by the corporations recognized for tax purposes by those courts shows that in each case the transactions were more numerous and had greater economic substance (i.e. were income producing) than the facts of the instant case.

1. The Esmond Mills v. Commissioner of Internal Revenue, 132 F. 2d 753, 43-1 USTC ¶9237 (1 Cir. 1943), cert. denied 319 U.S. 770, 63 S. Ct. 1432)

The issue was whether a wholly-owned subsidiary could be disregarded so that losses incurred by it could be deducted directly by its parent. In holding it could not be disregarded, the opinion of the Court of Appeals showed that the subsidiary did the following:

(a) It maintained separate books and records;

(b) It made purchases of cotton and wool in its own name and took title to the commodities;

(c) It made contracts in its new name;

(d) It reported income on its federal income tax return; and

(e) It reported assets on its balance sheet.

2. Andrew S. Love, et al. v. United States, 119 Ct. Cl. 384, 96 F. Supp. 919, 51-1 USTC ¶9276 (Ct. of Cl. 1951)

The individual taxpayers-partners contended the corporation was a nominee, to be disregarded for tax purposes. The Court of Claims opinion listed many transactions engaged in by the corporation in holding its separate existence must be recognized:

(a) The corporation rented the property to which it held legal title;

(b) It executed deeds of trust;

(c) It executed at least two deeds;

(d) It entered into at least one general option agreement to sell real property;

(e) It purchased and held fire insurance policies;

(f) It was sued;

(g) It brought suit;

(h) It filed employer payroll tax returns; and

(i) It paid unemployment compensation taxes as an employer of eight or more persons.

3. <u>Henry K. Given v. Commissioner of Internal Revenue, 238 F. 2d 579, 56-2 USTC ¶10,085 (8 Cir. 1956)</u>

In holding that the corporation in this case must be recognized as a separate taxable entity, the opinion mentioned these facts:

(a) Previous to the transaction involved in this case, the corporation had held title to four other pieces of real estate and had conveyed them when they were sold;

(b) Funds were deposited in a corporate account;

(c) The corporaton paid for repairs and improvements relating to the property in its name;

(d) Leases for space in the building were made in the corporate name;

(e) Rental receipts went into the corporate bank account;

(f) There was nothing in writing showing the corporation was to hold title in trust for or as agent for its stockholders; and

(g) Shares of the corporate stock changed hands.

4. <u>Hagist Ranch, Inc. v. Commissioner of Internal Revenue, 295 F. 2d 351, 61-2 USTC ¶9704 (7 Cir. 1961)</u>

The list of corporate activities which the Court felt determinative of its recognition as a separate taxable entity include:

(a) Its directors met 99 times with 17 shareholders' meetings;

(b) Over 80 leases were executed by the corporation as well as various other instruments and contracts;

(c) It paid dividends;

(d) It had preferred stock outstanding which it called for redemption;

(e) Numerous items of business are set forth in directors' and shareholders' minutes;

(f) It collected royalties; and

(g) It purchased additional acreage.

5. Tomlinson v. Miles, 316 F. 2d 710, 63-1 USTC ¶9439 (5 Cir. 1963), cert. denied 375 U.S. 828, 84 S. Ct. 71

Title to land was placed in a corporation for personal reasons (convenience in not having to obtain signatures of numerous owners). The corporation engaged in many transactions, thereby showing it was more than a mere nominee:

(a) It sold off separate pieces of real estate in seven separate transactions;

(b) It sold timber, receiving the proceeds, and paid real estate taxes;

(c) It executed assignments, satisfactions and partial releases of mortgages it held; and

(d) It maintained a corporate bank account.

6. John R. Collins v. United States, 386 F. Supp. 17, 75-1 USTC ¶9146 (D.C., So. Dist. Ga. 1974), aff'd 514 F. 2d 1282, 75-2 USTC ¶9553 (5 Cir. 1975)

A corporation was formed so that a mortgage loan could be obtained at an interest rate that would be usurious if made to an individual. Title was conveyed to the corporation.

In holding that the corporation was not a nominee for the individual-shareholder, the Court pointed out that the corporation had executed the apartment leases, which were assigned to the lending institution as security.

7. Harrison Property Management Co., Inc. v. United States, 201 Ct. Cl. 77, 475 F. 2d 623, 73-1 USTC ¶9292 (Ct. of Cl. 1973)

Individuals transferred title to oil-bearing acreage to a newly-formed corporation, reserving to themselves beneficial ownership in the land and lease income. The

purpose of the transfer was for efficient management.

The corporation engaged in various and numerous transactions as is evidenced by the sources of its revenue:

1. lease receipts;
2. proceeds from demolition of building;
3. profit from land sales;
4. rentals of camp; and
5. proceeds from sales of pecans.

It made various payments, further indicating the scope of its activities:

1. salaries to employees;
2. taxes;
3. litigation expenses; and
4. utilities and numerous other costs.

The corporation kept books, operated a bank account. It signed leases. It engaged in litigation. It held corporate meetings.

The Court had little trouble finding that the corporation performed business functions.

The Court went on to discuss the individual shareholders' argument that the corporation was an "agent" so that by operation of familiar legal principles the net income was really that of its "principal" (the individuals). It concluded that the facts did not support such a contention, which in the final analysis was only an effort to accomplish what subchapter S of the Code barred in this case (because of the large proportion of royalty income, subchapter S was not available for use).

We submit that the Harrison Property case is very much different from that of Heritage Village, Inc. which engaged in no business activities.

## II. THE TAX COURT BELOW INCORRECTLY APPLIED THE LAW TO THE FORM OF THE TRANSACTION RATHER THAN ITS ECONOMIC SUBSTANCE

A reasonable conclusion to be drawn from the facts in this case is that their economic substance is that the partnership was the owner of the project during 1968 and 1969 because:

(a) Once the buildings were completed, they were leased to apartment tenants by the partnership. The partnership (not the corporation) collected the rents;

(b) All costs of operating the project were paid by the partnership, including even the building construction costs;

(c) The corporation did nothing beyond what was needed to enable the lending institution to complete the loan transactions, i.e., the loan had to be to a corporation in order for the lending institution to be certain that the defense of usury could not be later asserted to avoid repayment of the loan.

The fact that legal title to the real property was in the corporation during the period loan advances were being made and the insurance coverage named the corporation as an insured (which had to be the case as it possessed record title) are but essen-

tial aspects of satisfying the New York usury statute.

(d) Every transaction that could be performed by the partnership in its own name (i.e., where record title to the fee of the real property was not directly involved) was done in its name as the owner of the project.

The following comments on the Opinion of the Tax Court rendered in this case suggest that the appropriate application of the law to the substance of transaction requires the adoption of taxpayer's position.

1. The Opinion quotes (at page 20) the Supreme Court's opinion in Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 63 S. Ct. 1132 (1943) to the effect that a corporation is to be treated as a separate taxable entity where the purpose of the corporation "... is the equivalent of business activity or is followed by the carrying on of business by the corporation ...".

In Moline, title to certain property was transferred to a corporation in 1928 so that its capital stock could be placed in a voting trust for the benefit of the lender on a mortgage loan secured by the property.

In 1933 the original loan was repaid and the capital stock returned to the individual who organized the corporation.

The corporation then re-mortgaged the property. Prior to that time the corporation defended condemnation proceedings and sued to remove restrictions on the

property.

In 1934 the corporation leased a portion of the property.

In 1934, 1935 and 1936 the corporation sold parcels of the property, which were reported on its 1934 and 1935 corporate tax returns.

The Court noted that when organized in 1928 the corporation was not even controlled by the individual (because of the voting trust); hence, it could not be said to be his alter ego.

The Court recited the above-mentioned transactions as constituting business activity.

The Supreme Court concluded that the gain on the 1935 and 1936 sales had to be reported by the corporation (and not in the individual shareholder's own returns as he contended on the ground that the corporation could be disregarded).

Although the Opinion of the Tax Court cites Moline as the "principal guidepost" (at page 19 of Opinion), it does not explain how use of the corporation to avoid usury laws is a business activity. In fact, such a use of the corporation is purely a legal mechanism to meet a legalistic exception in the usury statute. It in no way serves any business purpose.

A "business activity" means a transaction having to do with the economic utilization of the property - i.e., the earning of revenues or the expenditure of funds for operating costs.

The facts show that in the instant case it was the partnership that was involved in all business activities relating to the project.

2. The Tax Court cites Taylor v. Commissioner, 445 F. 2d 455, 72-1 USTC ¶9521 (1st Cir. 1971) as authority for recognizing a corporation as a taxable entity.

However, the facts in that case show much more was done by the corporation than merely holding fee title to land, viz:

It collected revenues from operating a gravel pit;

It opened a checking account;

It sold land, collected the proceeds and paid off a debt;

It executed deeds, buy-sell agreements and a mortgage.

The Taylor opinion, in fact, expressly states that:

> "If (the corporation) were to serve only as a straw, it should have only performed those transactions essential to the holding and transferring of title". (emphasis added) (445 F. 2d at page 457).

Heritage Village, Inc. did merely hold title so as to satisfy the usury statute.

3. The Tax Court also cites National Investors Corp. v. Hoey, 144 F. 2d 466, 44-2 USTC ¶9407 (2d Cir. 1944) as authority for recognizing a corporation as a taxable entity.

Some language from the opinion by L. Hand, Circuit Judge, is quite pertinent to our case:

> "... to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation: in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning ..." (144 F. 2d at page 468) (emphasis added).

Thus, the National Investors case would seem clearly to support our contention that a corporation's holding title just to satisfy a usury statute is not a "business" purpose in the "ordinary" meaning of that word.

4. The Tax Court Opinion cites an article in "The Tax Lawyer" ("Taxability of Straw Corporations in Real Estate Transactions", Kurtz and Kopp, 22 Tax Lawyer 647 (1969)) which is a well-reasoned discussion of the problems presented in the instant case.

It contains one suggestion which summarizes the rule as taxpayers would propose it (and which they have consistently applied):

> "To summarize, the basic problem of straw corporations should not be a theoretical one of whether a corporation should be ignored for tax purposes or whether it should be viewed as a taxable entity where the shareholder-owners chose to use the corporate form to hold legal title for non-tax reasons, but rather should be one of proof of who owns the property". (at page 656, emphasis added)

As the Tax Court acknowledged in our case, there is no doubt but that the partnership was at all times intended to be the owner.

5. The Tax Court at page 27 of the Opinion states that the corporation was treated by the partnership

in a manner inconsistent with taxpayer's contention that the two were the same entity. We feel we should answer this because it seems to go to the heart of the problem and suggests some misunderstanding by the Tax Court.

The partnership agreement (quoted at pages 5 and 6 above) shows clearly that the partnership was always to be the real owner of the property. It anticipated the need to use a corporate nominee to satisfy usury requirements.

It required that two signatures be required on a partnership deed. The fact that the lender was satisfied with the signature of Jones, alone, on the corporate loan documents is not inconsistent because from a lender's viewpoint it was not (and could not be) the partnership executing the documents. The partnership and the corporation could not be viewed by the lender as a single entity because of the real risk that the usury defense could be later asserted on the theory that the lender knew it was loaning to a non-corporate borrower (for the same reason the corporation could not be construed as "agent" for its "principal", the partnership, because the loan would then be deemed to be to the partnership and therefore usurious).

The mutual easements referred to by the Tax Court were necessary simply because there were different mortgagees of the parcels, so upon any foreclosure each had to be in a position where its parcel was entitled to necessary utility and other facilities. They are merely an adjunct to the mortgage itself, indistinguishable from the need that fee title itself be mortgaged.

The same comment applies to the need for insurance being applied for in the corporate name. The lender held a mortgage on the fee and therefore the insurance policy had to show the corporation as owner (but the policy also showed the partnership as owner, which further evidences how the partnership consistently reasserted and made known that it had a real and beneficial interest in the property).

Lastly, the fact that shareholders of the corporation are not personally liable on corporate debts is merely an automatic result stemming from the state corporation laws. Nothing in this case shows or suggests that protection from personal liability was a purpose of incorporation. Limitation on personal liability may be achieved in any event (if that were the goal) by appropriate exculpatory language in any note or mortgage executed by the partnership.

In fact, quite the opposite is the case because one of the partners did execute personal guarantees.

6. The Tax Court Opinion (at page 13) quotes from a memorandum from Jones to Aaron Kaiser. This merely reinforces the assertion that has been made by the partnership all along that it always takes the position that for all purposes (including "IRS considerations" as the memorandum puts it) the partnership is the real owner; hence, the instructions to deed the property from the corporation as soon as title no longer was required to be held in the corporation.

7. The impact of the Tax Court Opinion is vastly more far-reaching than might first appear. Not only does it retroactively (so far as the taxpayers are concerned) disallow losses which they had every reason based on precedent to believe they were entitled to deduct on their individual tax return, but the result of the Opinion raises other serious potential liabilities if its basic thesis is correct - i.e., that the corporation was the "real" owner of the project.

Such potential liability would result because in 1970 fee title to the project was unquestionably transferred from the corporation to the partnership and there was no further need for the corporation.

As 1970 was not a year under audit, it is not before the Tax Court. However, no broad consideration of the correct and equitable solution to the issues in 1968 and 1969 can fairly be made unless the full impact is discerned of the position arrived at by the Tax Court.

To merely point out the potential of taxable gain or loss which could result in 1970 from the "liquidation" of the corporation is, we submit, to reinforce our view that the Tax Court Opinion has so elevated form over substance that complication is piled on complication with tax burdens (if the liquidation were found to result in a gain) or tax refunds (were the liquidation found to result in deductible losses) materializing where no one could reasonably have thought either could exist.

To burden the real estate industry (and any others that need employ nominee corporations to meet some legal requirement) with such unforeseen and illogical penalties is not necessary or called for by either the legal precedents or sound reason.

To adopt taxpayers' position and accord recognition of the corporation for what it is - merely a device to satisfy a usury statute and nothing else - leads this Court to a sound, equitable and rational interpretation of the tax laws that neither bestows some improper benefit on the partners nor penalizes the U. S. Treasury.

III. <u>THE INTERNAL REVENUE SERVICE SHOULD NOT BE UPHELD IN ITS ARBITRARY APPLICATION OF A POSITION INCONSISTENT WITH PUBLISHED REVENUE RULINGS CONCERNING SIMILAR FACTUAL SITUATIONS</u>

While the Tax Court Opinion cites two recent rulings issued by the Internal Revenue Service, it does not attempt to distinguish them from the facts of this case.

We submit that those two rulings are in essence not distinguishable on the central issued involved, i.e., the use of a nominee corporation.

In the interests of fair and equal treatment of all taxpayers in similar factual positions, the position of the Internal Revenue Service established by these two rulings should apply and this case ought to be decided in favor of the taxpayers.

A discussion of each ruling follows:

Revenue Ruling 75-31, 1975-1 C.B. 10

A limited partnership was formed to own, construct and operate a housing project. It was desired to obtain financing from the New York State Housing Finance Agency ("HFA").

In order to do this, the regulations applicable under state law required the formation of a corporation (referred to as "H" in the Ruling) to which the loan would be made.

The Ruling (set out in full as Exhibit "A" to this brief) makes it clear that H was formed only to satisfy the regulations and that the beneficial owner of the property is the limited partnership.

The ultimate conclusion of the Ruling is that the partnership (rather than H) will be recognized for federal tax purposes as the owner of the property.

While there is much discussion in the Ruling about "principal" and "agent", we submit that there is no essential difference between forming a corporate "agent" to receive a loan and a corporate "nominee" to do the same. The objective is identical in both cases, i.e., to satisfy a state law requirement (under the housing law in the Ruling; under the usury law in this case) necessitating a corporate borrower.

Revenue Ruling 76-26, I.R.B. 1976-4,5

This Ruling (set out in full as Exhibit "B" to this brief) involves another New York statute for financing

low-income housing projects utilizing the facilities of the New York Urban Development Corporation ("UDC").

In its essentials it is comparable to the factual situation in Rev. Rul. 75-31, supra. It comes to the same conclusion, i.e. that the corporation formed to satisfy certain state regulatory objectives is not treated as the real owner of the property for federal income tax purposes, but rather the partnership is the real owner.

We suggest that each "agent" corporation referred to in the above Rulings had purposes well beyond the extremely limited purpose for which Heritage Village, Inc. was formed and used because they executed many more documents than merely the mortgage loan documents and, in fact, would even be in a position to take over active management of the property were the partnership subsequently to default on the loan.

The existence of the two corporations in the Rulings were just as essential to permit the financing to be consummated (the lenders required them) as was Heritage Village, Inc. in the instant case (each lender could make a loan to a corporate borrower only to avoid the defense of usury).

The nominee status of the corporation used by the partners to obtain financing for the apartment project was at all times recognized by the partners.

This is not a case of the Internal Revenue Service being misled into believing the corporation was intended to

be the real owner of the project. At all times Internal Revenue Service was aware of the nominee status of the corporation and that the partnership was the real owner of the project. The thrust of this is evident from these summarized facts:

1. The partnership was formed in early October, 1967, by the filing in public record offices of a partnership certificate followed in December, 1967, by the execution of a lengthy partnership agreement. These acts occurred <u>before</u> the closing of the first construction mortgage loan;

2. The partnership agreement as well as another agreement whereby certain partners agreed to convey certain parcels of land to the partnership expressly recognized that title to land may have to be held in a corporate nominee for the purpose of satisfying usury statutes and therefore the partners agreed such a corporate nominee on behalf of the partnership may be used - but at all times the beneficial ownership of the land was acknowledged to be in the partnership;

3. Internal Revenue Service was never misled into believing the corporation was to be treated as a taxable entity because the corporate tax form filed for the corporation reported no transactions and specifically stated that the corporation was a "nominee";

4. If the taxpayers had in fact contemplated that it would be the corporation that was to conduct

the business of owning and operating the apartments, they surely would have transferred to it <u>all</u> necessary assets to conduct such a business. Yet, the facts clearly show that <u>only</u> legal title to the land alone was ever conveyed to the corporation. All other operating assets were retained by the partnership;

5. Title to the land resided in the corporation only long enough to complete the apartments, when it was then conveyed to the partnership. The corporation was itself legally dissolved.

No doubt the Government will draw legalistic distinctions between the two Rulings cited and our case, but when the central issue is focused upon we submit there is no "real world" distinction.

If in truth taxation is a matter of substance over form, this surely is the case to apply such a principle.

Had 1968 and 1969 resulted in positive taxable income from the project instead of tax losses (arising principally from the deduction of construction interest and accelerated depreciation), it is interesting to speculate on whether IRS would have been so inclined to tax the net income to the corporation and not the individual partners.

Should IRS be permitted to be so arbitrary and unfettered by rational rules that taxpayers proceed at their own risk, not knowing until perhaps years later (as in this case) whether they are to be taxed as a corporation or a partnership?

IV. <u>ALTERNATIVELY, IF THE CORPORATION WERE FOUND TO BE ENGAGED IN "BUSINESS", THE INCOME AND EXPENSES OF THE PROPERTY ARE NOT ATTRIBUTABLE TO THE CORPORATION AFTER THE DATE ITS BUSINESS PURPOSE CEASED</u>

In <u>National Investors Corp. v. Hoey</u>, 144 F. 2d 466, 44-2 USTC ¶9407 (2d Cir. 1944) a corporate subsidiary was formed to hold stock of 3 existing subsidiaries as a preliminary step to a merger of the parent and all subsidiaries. The new subsidiary collected dividend income on stock it owned and itself paid dividends.

When the merger plan did not go through, the parent proceeded with a partial liquidation of the new subsidiary and deducted a loss on the first partial liquidation distribution.

The Commissioner of Internal Revenue claimed that once the plan of merger was disapproved by the parent's shareholders, the new subsidiary ceased to have a business purpose so any loss in value of the new subsidiary's stock attributable to the period <u>after</u> such disapproval could not be claimed by the parent (prior to such date the new subsidiary served a business purpose).

The opinion of Judge Hand measured the end of the "business" phase of the corporation's existence at the point when it became clear the merger plan was disapproved and the corporation should be liquidated.

Thus, in the Heritage Village situation, even if the Tax Court were found to be correct that the corporation was engaged in "business", the period in which the corporation was so engaged would have ended when the corporation

had executed the loan documents for each parcel of the project.

As parcel 1 was completed and the permanent mortgage executed on January 15, 1969 (see page 10 of Tax Court Opinion), the National Investors case at the least dictates that the partnership be deemed the "real" owner as to parcel 1 after that date (as the corporation ceased to have business activities as to parcel 1 on such date).

Yet, this is not the result of the decision because all income and expenses of parcel 1 are attributed to the corporation for all of 1968 and 1969.

The case of David F. Bolger, 59 T.C. 760, CCH Dec. 31,883 (1973) acq. I.R.B. 1976-20,6 is instructive on the issue mentioned above, i.e. who is entitled to the benefit of depreciation on the property - the corporation or the "real" owner. It found that the individual - Mr. Bolger - and not the corporation was entitled to the depreciation expense.

The same principle ought apply to the partners of Heritage Village Apartments Company as of the date the corporation is no longer needed with respect to each parcel (in the case of parcel 1, the date of the permanent mortgage loan, January 15, 1969). Yet, neither the Commissioner's notice of deficiency or the Tax Court decision does this.

A second issue which is raised by the Tax Court Opinion is which taxpayer, the corporation or the partnership, is entitled to "first user" status for depreciation

expense purposes under section 167 of the Code. The partnership elected 200% declining balance depreciation because (under its view) it was always the real owner, and therefore first user, of the property. Is its right to such election voided due to the interposition of the corporation as a taxable entity so that the corporation can be said to be the first user?

Because this issue was not resolved by the Tax Court, as it should have been because the year 1969 was before the Court, the Tax Court should be asked by this Court on remand of the case to resolve it (assuming that this Court has found for the Commissioner on the central issue of the corporate nominee status).

## CONCLUSION

The following statement in T. M. Britt and Jane Britt v. United States, 431 F. 2d 227, 70-1 USTC ¶9400 (5th Cir. 1970) at page 233 is a fair summary of the rule which Petitioners ask this Court to apply:

> "More particularly, we find that for tax purposes the courts will recast the form of a transaction to prevent a violation of the spirit if not the letter of the taxing statute in two basic circumstances:
>
> (1) When the taxpayer has conducted business as if he and the corporation were one and the same, thereby ignoring the fact that in tax law he and the corporation are considered to be two separate tax entities;
>
> (2) When artificial corporations have been created to contravene directly or indirectly the policies of the Internal Revenue Code."

We believe that, applying these tests to the instant case, there is no discernable policy or other reason to restructure the transaction to anything different than what the taxpayers always intended (and made known to I.R.S.) from the very outset - that the partnership is the real owner of the property and that the individual partners are responsible for reporting income and expenses of the property.

We respectfully ask that this Court reverse the decisions of the Tax Court and find for the petitioners-appellants.

Should this Court conclude that it agrees with the Opinion of the Tax Court as to the primary issue, we request

that this Court remand the case to the Tax Court with instructions to modify its Opinion on the issue of the inclusion of income and the deductability of expenses (including 200% declining balance depreciation) relating to parcel 1 so that after January 15, 1969 (when parcel 1 construction was completed and the permanent mortgage closed) the partnership is held to be the owner and first user of the property.

The authority for this action is clear from David F. Bolger (see discussion at page 44 above) and National Investors Corp. v. Hoey (see pages 43 and 44 above).

September 23, 1976

Respectfully Submitted,

Robert V. Hunter

Robert V. Hunter
Counsel for Petitioners-Appellants
P. O. Box 30
5795 Widewaters Parkway
Dewitt, New York 13214

Of Counsel:

HUNTER AND HARTNETT
P. O. Box 30
5795 Widewaters Parkway
Dewitt, New York 13214

Rev. Rul. 75-31

Based on the facts and circumstances set forth below, advice has been requested whether a limited partnership formed under New York State law is to be treated as the owner of certain land and improvements thereon ("project") for Federal income tax purposes and whether each partner of such partnership may include a portion of a loan made by the New York State Housing Finance Agency ("HFA") in the basis of his partnership interest.

*D*, a corporation organized under the laws of the State of New York, has a net worth of $10,000x. The primary business of *D* is the acquisition, development, ownership and/or management of real estate properties.

With regard to the project, *D* determined that it would be desirable to obtain most of the funds required for acquisition and construction through a loan from HFA and the balance of the required funds by capital contributions made by partners (including *D* itself) to a limited partnership, *X*, formed under the New York Uniform Limited Partnership Act in which *D* is to be the managing general partner.

*D* organized *H*, a Limited Profit Housing Company ("LPHC"), with nominal capital to receive the desired financing for the project by means of a loan from HFA. All the stock of *H* is owned by *D*. *H*'s only asset is a $100 capital contribution that was made so that it could be organized under New York law. In certain documents described below, *H* was designated as a general partner of *X* for certain limited purposes in order to make the HFA loan available to *X* to develop the project. The HFA loan was made to *H*.

The reasons for this indirect method of financing, a description of the organizations involved and the provisions of New York law under which the organizations operate are set forth below.

The New York State Division of Housing and Community Renewal ("DHCR") is created under sections 10 and 11 of the New York Public Housing Law and is charged under the New York Private Housing Finance Law ("PHFL"), *inter alia*, with supervision of the development and operation of the project including determining the conditions under which the HFA mortgage loan will be made, monitoring progress of construction and approving requisitions for advances on the HFA loan, specifying the allowable rentals, regulating the owner's profits and distributions and approving all contracts of the owner.

HFA was created by section 43 of the PHFL as "a corporate governmental agency, constituting a public benefit corporation." HFA may make mortgage loans for the purpose of financing certain projects, including low income housing projects of the type herein described. HFA may make loans for such projects only with the approval of the Commissioner of Housing and Community Renewal ("Commissioner of DHCR") who is guided by provisions of Article 2 of the PHFL governing state loans. Under provisions of the PHFL and the rules of DHCR such loans may be made only to a LPHC.

A LPHC is a corporation organized pursuant to Article 2 of the PHFL or the Not-For-Profit Corporation Law of the State of New York and such Article 2, for the purpose of providing, among other things, certain types of low income housing.

Article 2 of the PHFL requires, among other things, that the certificate of incorporation of a LPHC must be approved by DHCR before it is filed with the New York Secretary of State. The certificate of incorporation must state that the LPHC is organized to serve a public purpose, that it shall remain subject to the supervision and control of the Commissioner of DHCR as long as Article 2 of the PHFL remains applicable to any project of the LPHC, and that all real and personal property acquired or created by it shall be deemed to be acquired or created by it to properly effect the purposes of Article 2 of the PHFL. The pur-

Exhibit "A"

poses of Article 2 are stated therein to include encouragement of private investment in companies engaged in providing low income housing which are regulated by law as to rents, profits, dividends, and disposition of their property and encouragement of participation of HFA in financing such housing.

Article 2 of the PHFL also requires that the certificate of incorporation of a LPHC state that in the event the LPHC violates any provision of its certificate of incorporation, of the law, or the loan or mortgage contract, or any order, rule or regulation of the Commissioner of DHCR, the Commissioner of DHCR may remove any or all of the directors of the LPHC and appoint new directors to serve until the violation is cured and the Commissioner of DHRC has received assurances satisfactory to him that violations will not reoccur.

Section 44(9) of the PHFL provides that the power of HFA to make a loan to a LPHC and to secure repayment of the loan by mortgage is subject to the approval of the Commissioner of DHCR. Further, section 27(4) of the PHFL provides that without first having the written consent of the Commissioner of DHCR, a LPHC may not construct any project or contract for the construction, sale, transfer, or assignment of any of its real property (except in the event of a foreclosure sale) or enter into any contract for the operation of the project.

Section 16 of Article 2 of the PHFL provides that, subject to regulations prescribed by the Commissioner of DHCR, a LPHC may be a partner in a partnership formed for the sole purpose of providing the LPHC with capital. A partner in such a partnership may but is not required to own the shares of the LPHC.

The Commissioner of DHCR determined that the arrangement described herein falls within and meets the provisions of the PHFL, including the provisions described above, as well as the regulations of the DHCR. Consistent with said determination, the Commissioner of DHCR approved the certificate of incorporation of *H*, the LPHC, the certificate of limited partnership and the partnership agreement of the members of *X*. These approvals were signified in writing at the end of the documents.

All of the equity capital of *X* was contributed by *D* and the limited partners; none of the equity capital of *X* was contributed by *H*. None of *X*'s capital will be invested in *H* and none of the limited partners of *X* has or will have any interest in *H*. The limited partners have a 99 percent interest in the items of income, gain, loss, deduction and credit of *X*, and *D*, in its capacity as general partner, has a one percent interest in such items. *H* has no interest in any item of income, deduction, gain, loss or credit of *X* during the existence of *X* or in any property of *X* upon its dissolution or liquidation. No amount was or will be paid to *H* by *X* or *D* for any act performed by *H* on behalf of *X*.

After *X* was formed and capitalized by *D* and the limited partners as described above, the following transactions occurred at the closing of the HFA loan. *H* executed a building loan contract, a note for the HFA loan and a mortgage on the project to secure repayment thereof ("the loan documents") in its own name, and not as general partner, without otherwise signifying thereon that it was acting on behalf of anyone but itself. *H* took legal title by deed to the land in its own name and simultaneously therewith *H* and *X* executed a Declaration of Interest ("Declaration") that stated (1) *H* had acquired and would continue to hold title to the land and any improvements thereon as a general partner of and on behalf of *X*; (2) *X* has the equitable interest in the project, notwithstanding that *H* holds legal title to such project; (3) *H* has no interest, and will never have any interest in the items of income, gain, loss, deduction, credit or capital of *X*, nor will it have any beneficial interest in any receipts, investment or other property of *X*; (4) *H* has no authority to impose personal liability on *X* or any partner thereof except *H* with respect to the HFA loan and therefore *H* executed the loan documents in its own name so that no partner of *X* other than itself will be liable thereon; (5) no party to the loan documents, or any successor, pledgee or assignee of such party, will have recourse against *X* or any partners thereof other than *H* for the amount due under the loan documents; and (6) *H* became a general partner of *X* pursuant to, and solely for the purpose of, section 16 of Article 2 of the PHFL.

Further, the Declaration states that all loan proceeds, all income realized in the operation of the project which are subject to the lien of the mortgage, and all DHCR required equity capital of *X*, will be deposited in accounts in the name of *H* as general partner of *X*, but that H will have no equitable interest in such proceeds, income or capital directly or as a partner of *X*; that subject to limits imposed by Article 2 of the PHFL, the loan documents, and the approval of DHCR, *H* will, upon direction of *X*, sell, assign, or otherwise transfer the project property to *X*'s assignee; that upon repayment of the HFA loan, *H* will forthwith convey legal title to such project to *X* and thereafter dissolve; and that copies of the certificate of incorporation of *H*, the partnership agreement, the certificate of limited partnership of *X* and the loan documents are available at the offices of DHCR for public inspection.

The Declaration was approved by DHCR, the approval being signified in writing at the end of the Declaration.

At the closing of the HFA loan, HFA signed and delivered a letter addressed to *H* and to DHCR ("HFA Letter") stating that HFA was acknowledging receipt of copies of the Declaration, the certificate of incorporation of *H*, the partnership agreement and the certificate of limited partnership and that HFA was making its mortgage loan subject to the provisions of the Declaration, including that portion which states that no party to the loan documents, or any successor, pledgee or assignee of such party, shall have recourse against the partnership, or any partners thereof, other than *H*, for any amount due under the loan documents.

Also at the closing of the HFA loan, the attorney for HFA on behalf of HFA signed and delivered to *H* and to DHCR a letter addressed to *H* and to DHCR ("HFA Attorney Letter") which recites that under applicable authority (including Restatement of the Law of Agency 2d sec. 150 Comment c and *Huntington Pennysaver Inc. v. Tire Supply Corporation of Long Island*, 59 Misc. 2d 268; 298 N. Y. S. 2d 824 (Dist. Ct. Suffolk Co. 1969) discussed below) the legal effect of the HFA Letter and Declaration is that no person other than *H* is or will be liable for repayment of such loan. The attorney for DHCR, on behalf of DHCR, concurred in writing to the HFA Attorney Letter. In both the HFA Letter and the HFA Attorney Letter, *H* and DHCR are authorized by HFA to make these two letters available in such manner, for such purposes, and to such persons as shall be necessary to facilitate the closing of the HFA loan and the development of the project. Finally, at closing, the HFA Letter and the HFA Attorney Letter were both attached as exhibits to and were incorporated by reference into the Declaration which stated that the approval of and agreement to the terms of the Declaration by *X* and *H*, were in consideration for, in reliance upon, and expressly subject to the provisions of these two letters and the approval by DHCR of the HFA loan and the terms of the Declaration was expressly subject to the provisions of these two letters.

Immediately after the closing of the HFA loan, the deed to the project site, the mortgage securing the HFA loan, a copy of the certificate of limited partnership of *X*, and the Declaration (to which are attached as exhibits copies of the HFA Letter and the HFA Attorney Letter) were all simultaneously filed in the appropriate records in the office of the local County Clerk and thereby made a matter of public record.

Neither *X*, nor *D*, nor any of the limited partners assumed any liability with respect to the repayment of the HFA loan or entered into any other agreement to repay it, guarantee its repayment, or otherwise incur any obligation to repay it.

Consistent with the Declaration described above, the partnership agreement of *X* provides that *H* will acquire and hold legal title to the project as general partner of, and on behalf of *X* which has the equitable interest therein. All HFA mortgage loan advances, partners' contributions of required equity and managing agent remissions of net rentals, are deposited directly in accounts entitled "*H* as general partner of *X*." The partnership agreement of *X* further states, subject to the provisions set forth as 1 and 2 below, that all the powers and rights of the general partners of *X* are vested in *D* to the exclusion of *H*.

1. As required by DHCR, *H* will execute various documents pertaining to the development and operation of the project including the loan documents, the construction contract, the architect's agreement, the managing agent's agreement, the leases of units in the project, the accountant's agreement, and the attorney's agreement. These documents will be executed by *H* as general partner of, and on behalf of *X*, except that the loan documents are to be executed only in *H*'s own name. The partnership agreement recites that the purpose of this exception is to cause neither *X* nor any partners of *X* (other than *H*) to be liable for the repayment of the HFA loan.

2. *H*, as general partner, will be responsible to DHCR for assuring that *X*'s development, management and operation of the project conform with the requirements of the PHFL, the rules and regulations of the DHCR, and the loan documents. During the period of supervision by DHCR (that is, so long as Article 2 of the PHFL remains applicable), the Commissioner of DHCR can remove and replace any of *H*'s directors (in accordance with previously described provisions in *H*'s certificate of incorporation), and the Commissioner of DHCR can, pursuant to specific and required terms of the partnership agreement, terminate *D*'s right to exercise the rights and powers of the general partners and direct *H* to exercise them. In such event, such rights and powers must be exercised by *H* only upon, and in accordance with, the directions of DHCR. Such exercise by *H* lasts until DHCR determines that such rights and powers may revert to *D*.

Again consistent with the Declaration, the partnership agreement and certificate of limited partnership of *X* recite that *H* is a general partner pursuant to, and solely for the purposes of section 16 of the PHFL. The partnership agreement and certificate of limited partnership further provide that any reference in the agreement or certificate, direct or indirect, to the status of *H* as a partner of *X* refers only to its status as a partner for purposes of section 16 of the PHFL.

Any transfer of a limited partner's interest in *X* is subject to the prior written

approval of DHCR. Furthermore, distributions of cash or proceeds to limited partners are subject to the provisions of the PHFL, the rules and regulations of DHCR, and the loan documents.

*H* files annually a Form 56, Notice of Fiduciary Relationship, with the Internal Revenue Service which states that it acts for or on behalf of *X* under authority contained in the Declaration.

Section 752(c) of the Internal Revenue Code of 1954 provides that, for purposes of section 752 of the Code, a liability to which property is subject shall, to the extent of the fair market value of the property, be treated as a liability of the owner of the property.

The specific question to be resolved at this point is whether for Federal income tax purposes, *X* will be treated as the owner of the project and the improvements thereon subject to the HFA loan indebtedness.

In determining whether *X* is to be treated as the owner of the project site and the improvements thereon for Federal income tax purposes, it is necessary to determine the capacity in which *H* holds title to the property, that is, whether it holds as agent on behalf of *X* or on its own behalf.

In any case in which a purported principal owns a controlling stock interest in its purported corporate agent, whether an agency relationship will be recognized for Federal income tax purposes is determined by reference to more than the presence of the usual incidents of an agency relationship. If a corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned in substantial part by the principal. *National Carbide Corporation v. Commissioner*, [49-1 USTC ¶9223] 336 U. S. 422 (1949). The significant criteria that must be examined are whether "the so-called 'agent' would have made the agreement if the so-called 'principals' were not its owners, and conversely whether the 'principals' would have undertaken the arrangement if the 'agent' were not their corporate creature." *Harrison Property Management Co., Inc. v. United States*, [73-1 USTC ¶9292] 475 F. 2d 623, 627 (Ct. Cl. 1973), *cert. denied* 414 U. S. 1130, *reh. denied* 415 U. S. 952 (1974). Thus, for a true agency relationship to exist, it must be shown that the principal's control over the corporation's functions in an agent's capacity rests on a relationship independent of any control attributable to stock ownership. In determining whether an agency relationship exists pursuant to that test, the Service has consistently taken the position that all the facts and circumstances must be considered. See Rev. Rul. 54-596, 1954-2 C. B. 51; Rev. Rul. 59-247, 1959-2 C. B. 14.

In the instant case, the Declaration contains a specific acknowledgement by *H* that it holds record title to the project site and any improvements thereon on behalf of *X*. This is reiterated in the partnership agreement and the partnership certificate, and is consistent with *H*'s certificate of incorporation. Knowledge of the existence of the agency relationship is not limited to the contracting parties but instead is made a matter of public record since the Declaration is filed in the public land records and since copies of the certificate of incorporation of *H*, the partnership agreement, the certificate of limited partnership of *X* and the loan documents are available at the offices of DHCR for public inspection.

Although the foregoing is indicative of an agency relationship, as noted above, the existence of an agency relationship must not be dependent upon the controlling stockholders' ownership of the corporation.

In *National Carbide Corporation v. Commissioner*, above, the claim of an agency relationship between the parent corporation (the purported principal) and its subsidiaries (the purported agents) was rejected because it rested on the control which the parent exercised over its subsidiaries through and by virtue of its stock ownership of the subsidiaries. The various indicia advanced in support of the claimed agency were equally consistent with and could be explained by the corporation—sole stockholder relationship.

By contrast, the agency relationship in the instant case in respect of the project does not rest upon *D*'s stock ownership of *H*. *H* is a party to the arrangement because of the New York statutory scheme that requires DHCR to supervise the development, construction and management of the project through a LPHC, that is, *H* in this case. This supervision and control of the project by DHCR through *H* is assured to DHCR through provisions in *H*'s charter required by the New York statutes governing such projects. *D* is not free to remove these charter provisions by amendment. The control which *D* has over *H* through its stock ownership in respect of the project is subject to and limited by these charter provisions, and the statutes, rules and regulations of the State of New York and DHCR. If *D*, through its stock ownership, exercises control over *H* in a manner inconsistent with these charter provisions, statutes, rules and regulations, *D*'s control of *H* may be divested by DHCR.

Accordingly, it is concluded that the agency relationship between *X* and *H* expressed in the Declaration, partnership agreement, certificate of partnership, and other documents approved by DHCR, does not rest upon the corporation—stockholder relationship between *H* and *D*, and should be recognized as existing independently of that relationship by reason of the unique facts and circumstances described herein.

*Cf., Carver v. United States,* [69-2 USTC ¶9476] 412 F. 2d 233 (Ct. Cl. 1969). Therefore, the agency will be recognized for Federal income tax purposes.

When a partnership is the owner of property and no partner of the partnership is personally liable for repayment of the liability to which the property is subject, all the partners of the partnership, including its limited partners, shall be considered as sharing such liability under section 752(c) of the Code in the same ratio as they share partnership profits. See section 1.752-1(e) of the Income Tax Regulations.

The second question to be resolved is whether any partner of *X* is personally liable for the repayment of the loan to HFA.

*H* has no interest and will never have an interest in any item of income, gain, loss, deduction, credit or capital of *X*, nor will it have any beneficial interest in the receipts, investments or other property of *X* during the operation or upon the liquidation of *X*. Therefore, under these circumstances, *H* will not be considered a partner of *X* for Federal income tax purposes. See *Hubert M. Luna,* [CCH Dec. 26,967] 42 T. C. 1067 (1964). Since *H* is not considered a partner for Federal income tax purposes, the personal obligation of *H* to repay the loan to HFA is of no consequence in determining whether any partner of *X* is personally liable for repayment of the liability to which the project is subject.

No party other than *H* signed the note; therefore, if the note is considered negotiable, only *H* may be held liable thereon. See N. Y. Uniform Commercial Code sec. 3-401(1). Furthermore, whether or not the note is negotiable, an agreement that an agent enters into in his own name on behalf of a disclosed principal can contain a provision in which a third party agrees not to look to the principal for payment. In such a case the principal will not be liable for repayment of the underlying obligation. Restatement of the Law of Agency 2d sec. 150 Comment c. This rule and its result has been recognized in *Huntington Pennysaver, Inc. v. Tire Supply Corporation of Long Island,* 59 Misc. 2d 268, 298 N. Y. S. 2d 824 (Dist. Ct. Suffolk Co. 1969).

At the closing of the HFA loan, HFA signed and delivered the HFA Letter and the HFA Attorney Letter, which were filed of record as noted above. As recognized in the HFA Attorney Letter, the legal effect of the HFA Letter under New York law is substantially the same as that cited in the above authorities, that is, the creditor, HFA, agrees that the disclosed principal, *X*, is not liable for repayment of the loan. Therefore, in the instant case, no person other than *H* is liable for repayment of the loan. Thus, whether or not the note is considered negotiable, neither *X* nor *D* could be held liable on the underlying obligation. Since *X*, the partnership, cannot be held personally liable, *D*, the only general partner recognized as such for Federal income tax purposes, may not be held personally liable as a partner.

Thus, since no person who is considered a partner of *X* for Federal income tax purposes is personally liable for the obligation to HFA under the laws of New York governing the arrangement, *D* and the limited partners share the liability for the HFA loan in the ratio in which they share partnership profits under section 752(c) of the Code and section 1.752-1(e) of the regulations so long as *D* retains its power to manage the project of *X*, and *H* has not been caused to assume such responsibility by DHCR.

This Revenue Ruling does not deal with the requirements for an organization to be classified as a partnership for Federal income tax purposes. See section 301.7701-2 of the Procedure and Administration Regulations. See also Rev. Proc. 72-13, 1972-1 C. B. 735 and Rev. Proc. 74-17, 1974-22 I. R. B. 17, in connection with obtaining advance rulings regarding the classification of limited partnerships. Furthermore, the conclusions contained in this Revenue Ruling are not changed if *D* were an individual.

Based on the facts and circumstances set forth below, advice has been requested whether a limited partnership formed under New York State law is to be treated as the owner of certain land and improvements thereon for Federal income tax purposes.

$X$ was formed as a limited partnership under the laws of the State of New York for the purpose of building and operating a 139-unit housing project (the project) to provide low-income housing. The project was financed by a mortgage loan from the the New York State Urban Development Corporation (UDC).

UDC is created under Section 6254 of the New York State Unconsolidated Laws as a "corporate governmental agency of the state constituting a political subdivision and public benefit corporation" and is charged under the New York State Urban Development Corporation Act (UDC Act) with the supervision and development of various types of projects, residential and non-residential, including the making of mortgage loans, monitoring the progress of construction, specifying the allowable rentals, regulating the owner's profits and distributions, and approving all contracts of the owner. Under the UDC Act, loans may only be made to a Limited Profit Housing Corporation (LPHC), as described in Article 2 of the New York State Private Housing Financing Law (PHFL) and then only if the LPHC is a subsidiary of UDC.

$X$ has 3 general partners, including $M$, a domestic corporation which serves as managing general partner, $S$, a nominally capitalized LPHC, and $P$, a domestic corporation which owns all the outstanding stock of $S$. In addition, $X$ has 15 limited partners.

$S$ was initially formed as a subsidiary of UDC with UDC subscribing for but not purchasing, all of the shares of $S$ and electing all its directors. The certificate of incorporation of $S$ was approved by UDC and recites that $S$ is organized to serve a public purpose, that $S$ shall remain subject to the supervision and control of UDC so long as Article 2 of the PHFL remains applicable to the project and that all property acquired, created or rehabilitated by $S$ shall be deemed acquired, created, or rehabilitated for the proper effectuation of the purposes of the article and the UDC Act. At the closing of the mortgage loan discussed below, UDC surrendered its subscription rights for the shares of $S$ to $P$.

Although all of $S$'s stock is owned by $P$, in the event UDC determines that $M$ is not meeting its responsibility as managing general partner, UDC has the right under a stock pledge agreement and irrevocable proxy between UDC, $S$ and $P$ to vote the stock of $S$, to assume control of $S$ and to direct $S$ to assume all the functions and powers of the managing general partner of $X$. Under the stock pledge agreement and irrevocable proxy, $P$ transfers all its right, title and interest in the $S$ stock back to UDC. UDC's rights under the stock pledge agreement and irrevocable proxy are also recited in the partnership agreement. The purposes of the pledge, as recited therein, are to secure the performances of $S$ and $X$ under an Equity and Regulatory Agreement (described below) and to protect the public interest and the interest of UDC in the project.

UDC, $S$, and $X$ entered into an Equity and Regulatory Agreement that sets forth the manner of payment of the costs of the project, the responsibilities for and regulations of the project and the remedies of UDC in the event of default. UDC agrees that neither it nor any subsequent holder of the note shall have any claim to proceed personally against $S$, $X$ or any partner and that it will look solely to the project assets for satisfaction of any claim. The agreement acknowledges that $X$, pursuant to the partnership agreement has active responsibility and will actively carry out the development, construction, management, operation, and maintenance of the project, subject to the rights of UDC under the stock pledge agreement and the partnership agreement to have $S$ assume management responsibilities for the project.

The cost of the Project was 4,000$X$ dollars of which 450$X$ dollars was provided by the capital contribution of the limited partners. The balance of the cost, 3,550$X$ dollars was obtained by $S$ through a loan from UDC.

Hence, all the equity capital of $X$ was contributed by the limited partners with none of the equity capital invested by $S$. None of $X$'s capital was invested in $S$ and none of the limited partners of $X$ had any interest in $S$. The limited partners, under the partnership agreement, have a 97 percent interest in the items of income, gain, loss, deduction, and credit of $X$. $M$, in its capacity as management general partner, has a 3 percent interest in these items. $S$ has no interest in any item of income, deduction, gain, loss, or credit of $X$ during the existence of $X$ or in any property of $X$ upon its dissolution or liquidation. No amount was or will be paid to $S$ by $X$ or any general partner for any act performed by $S$ on behalf of $X$.

$S$ acquired the property on which the Project was constructed from UDC and executed a building loan agreement in the principal amount of 3,550$X$ dollars. This agreement was secured by a mortgage and evidenced by a note. These loan documents provided that neither $S$ nor any partner of $X$, general or limited, were personally liable for the repayment of the loan. The proceeds of the loan were deposited into accounts of $X$ maintained in a bank approved by the UDC. Withdrawals were made by UDC and were not made by $X$ without authorization from UDC.

$S$ executed the loan documents, the land conveyance agreement, and the deed in its own name and not as a general partner of $X$, and simultaneously therewith executed a declaration of interest (declaration) which stated that $S$ executed the mortgage loan and acquired the land as general partner of

Exhibit "B"

*X* and that *X* had equitable interest in the project. Consistent with the declaration, the partnership agreement and certificate of limited partnership provide that *S* will acquire and hold legal title to the project as general partner of and on behalf of *X* which holds the equitable interest therein. In addition, the deed to the project site, the mortgage securing the UDC loan, a copy of the certificate of limited partnership of *X*, and the declaration were all filed in the appropriate records in the office of the local county clerk and thereby made a matter of public record.

*S* annually files a Form 56, Notice of Fiduciary Relationship, with the Internal Revenue Service which stated that it acts for or in behalf of *X* under authority contained in the declaration.

The specific question to be resolved is whether, for Federal income tax purposes, *X* or *S* will be treated as the owner of the project and the improvements thereon subject to the UDC indebtedness.

In determining whether *X* is to be treated as the owner of the project site and the improvements thereon for Federal income tax purposes, it is necessary to determine the capacity in which *S* holds title to the property, that is, whether it holds title as agent on behalf of *X* or in its own behalf.

Section 752(c) of the Internal Revenue Code of 1954 provides that, for purposes of section 752, a liability to which property is subject shall, to the extent of the fair market value of the property, be treated as a liability of the owner of the property.

Rev. Rul. 75-31, 1975-1 C. B. 10, involves a similar factual situation in which a housing project was financed by the New York State Housing Finance Agency (HFA) through a LPHC. In determining whether the LPHC owned the project in Rev. Rul. 75-31 as a mere nominee of a limited partnership, the Revenue Ruling utilized a two step analysis that, as applied to the instant case, requires determinations of (1) whether evidence of agency relationship exists between *S* and *X*, and if so, (2) whether the relationship results merely from the stockholder relationship between *S* and *P*.

In the instant case, the declaration, partnership agreement, and the certificate of limited partnership contain specific acknowledgements by *S* that it holds record title to the project site and improvements thereon as a general partner of and on behalf of *X*. These acknowledgments are consistent with *S*'s certificate of incorporation. In addition, knowledge of the existence of the agency relationship was not limited to the contracting parties, but was a matter of public record because the declaration and certificate of limited partnership were properly filed in the county clerk's office.

Furthermore, *S* is a party to the transaction solely because of the New York State statutory scheme governing low-income housing projects that requires UDC to supervise the development, construction, and management of the project through a LPHC. This supervision and control of the project by UDC is assured by the stock pledge agreement and irrevocable proxy, by the Equity and Regulatory Agreement, and by the partnership agreement. The control that *P* and *X* have over *S* is limited by these agreements and by the rules and regulations incorporated therein.

Accordingly, the agency relationship existing between *S* and *X* does not rest upon a corporation-stockholder relationship between *S* and *P* and is recognized as existing independently of that relationship. Therefore, for Federal income tax purposes, *X* is treated as the owner of the project.

This Revenue Ruling does not deal with the requirements for an organization to be classified as a partnership for Federal income tax purposes. See section 301.7701-2 of the Procedure and Administration Regulations. See also Rev. Proc. 72-13, 1972-1 C. B. 735, and Rev. Proc. 74-17, 1974-1 C. B. 438, in connection with obtaining advance rulings regarding the classification of limited partnerships.

The instant case is distinguishable from Rev. Rul. 75-31 on the question of whether any general partner of the limited partnership is personally liable for repayment of the loan. HFA programs differ from UDC programs in that loans made by the HFA are recourse obligations to the LPHC. In the instant case the loan to *S* was a nonrecourse obligation under which the UDC agrees to look solely to the project assets for satisfaction of any claim. Hence, the question of the partner's personal liability is not present in the instant case.